incomes commission

n des prix et des revenus

For Release at 1:00 p.m.
Friday, February 25, 1972

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Wellington Street
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[General publications]

[G-35] REFLECTIONS ON INCOMES POLICY

Address delivered by
John H. Young
Chairman
Prices and Incomes Commission
to the
Industrial Relations Management Association of B.C.
February 25, 1972

Harrison Hot Springs, B.C.

Canada

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This country was a late comer in the field of prices and incomes policy. Until the latter part of the 1950s few Canadians saw the need for direct intervention to limit price and income increases and during the period of relatively high unemployment in the early 1960s little attention was given to wage-price problems. The inflation of the mid-60s raised the question again, but the attitude of economists and the Canadian public was reflected in the negative verdicts on the use of general prices and incomes policy by the Economic Council in 1966, and the Task Force on Industrial Relations in 1968.

Thus when the Government issued a White Paper on Policies for Price Stability in December 1968 it took a very cautious position on what might be done. The White Paper did point out, however, that the Government had concluded that the means available to it were not sufficient ". . . to resolve the very real conflict which exists at the present time between the objectives of maintaining high level employment and restoring the price stability that is necessary for sustained economic growth." Following the plan outlined in the White Paper, the Government appointed a Prices and Incomes Commission on June 19, 1969, ". . . to inquire into and report upon the causes, processes and consequences of inflation and to inform those making current price and income decisions, the general public and the

. . .2

This country saw a late onset of the debate on prices and incomes policy. Until the latter part of the 1960's the Canadians, on the other hand, [illegible] attention to their price and income increases, and during the period of relatively high unemployment of the early 1960's little attention was given to wage-price guidelines. The initiative at the outset [illegible] the question again, but the [illegible] of [illegible] and the Canadian public was [illegible] in the [illegible] of the use of general prices and incomes policy by the Economic Council in 1966, and the Task Force on Labour Relations in 1968.

Thus when the Government issued a White Paper on Policies for Price Stability in December 1968 it took a more cautious position on what might be done. The White Paper did point out, however, that the Government had concluded that the means available to it were not sufficient to [illegible] the wage and price conflict which existed at the present time between the objectives of maintaining high employment and restraining the price increases [illegible] necessary for sustained economic growth. Following the [illegible] outlined in the White Paper, the Government appointed a Prices and Incomes Commission on [illegible] 19, 1969, "... to inquire into and report upon the causes, processes and consequences of inflation and to inform those making decisions about prices and incomes [illegible], the general public and the

Government on how price stability may best be achieved."

Today I would like to give a general outline of some of the things the Prices and Incomes Commission has done over the last two and a half years, and touch very briefly on some of the things which have been learned.

Many of the critics of the Commission have suggested that all would have been well if it had limited its activities to research. Certainly our life would have been a good deal more peaceful if we had stayed in the back room. As soon as the Commissioners were appointed, however, we quickly gathered the impression that there would be widespread disappointment and criticism if no help were offered in dealing with current issues.

By 1969 the inflationary problem had become a serious one with prices having risen for about four years at more than double the rate of the early 1960s. The first attempt to deal with this inflation by levelling out the economy in 1966-67 did not go far enough or last long enough to dampen down price and income increases, and a much more vigorous policy of demand restraint was imposed in 1968-69.

Given the inflationary momentum which had developed, it was clear that if reliance were placed on the use of demand instruments alone, reasonable price stability would only be

restored at a heavy price in terms of unemployment and lost output. It was this which led us in August 1969 to seek an agreement among the major interest groups looking towards a direct scaling down of price and income increases. In the course of the weeks that followed, about 100 meetings were held both jointly and singly with representatives of the business community, labor unions, professional groups, trade associations and governments. As discussions proceeded, it was evident that difficulties were arising on the union front. On October 17 the presidents of the two major labor federations held a joint press conference and announced that while they would welcome a price control system (which, if necessary, drew attention to cost increases), they were unprepared to accept guidelines on wage and salary increases.

By this time, however, governments and the business community had developed enough interest in the project to be prepared to carry on negotiations about a limitation on prices with the hope of obtaining a positive response from labor at a later date. We and the remaining groups then proceeded to organize a National Conference on Price Stability. At this Conference the members of the business community present agreed that if called upon to do so, business firms in Canada would be prepared to reduce the number and size of price increases in 1970, and in particular would limit price increases to a level which yielded revenue increases clearly less than the cost increases the firm had to bear during the period. At a

figures at a heavy price in terms of unemployment and lost output. It was this which led me in August 1969 to seek an agreement among the major industry groups looking to possible direct action, to deal with price and income increases. In the course of the weeks that followed, talks with the sectors were held severally and finally with representatives of the business community, labour unions, professional groups, other associations and governments. As discussions progressed, it was evident that difficulties were emerging on the labour front. On October 11 the presidents of the two major union federations held a joint press conference and announced that while they would welcome a price control system if necessary, once attention to cost increases, they were unprepared to accept guidelines on wage and salary increases.

By this time, however, governments and the public generally had developed enough interest in the project to be prepared to carry on negotiations about a limitation on prices with the hope of obtaining a qualified response from labour at a later date. We and the same other groups then proceeded to organize a National Conference on Price Stability. At this conference the members of the business community present agreed that if called upon to do so, business firms in Canada would be prepared to reduce the number and size of price increases in 1970, and in particular would limit price increases to a level which yielded percentage increases clearly less than the cost increases the firm had to bear during the period. At a

meeting of the First Ministers of the Federal and Provincial governments a week later, this agreement was endorsed by the governments and the Prices and Incomes Commission was authorized to call on all members of the business community to observe these criteria. The governments agreed that, if necessary, they would use their powers to persuade firms to abide by the criteria.

We administered the price restraint program throughout the rest of 1970. It is always difficult to assess the effect of such an effort. Our staff identified around a hundred examples where price increases had been postponed, reduced or abandoned, but there is no reliable way of translating this into price index terms. A glance at Canada's over-all price performance in 1970 could easily leave the impression that a great deal was accomplished. Between December 1969 and December 1970, the increase in the consumer price index was 1.5 per cent - a level substantially lower than that of any other industrial country. There were many other forces at work during this period, however, including the general softness of market conditions, the appreciation of the Canadian dollar in the second half of the year, a fall in farm prices and a price war between grocery chains in a number of major retail markets.

It was not to be expected that the price restraint program would have a major and lasting effect on the rate of price increase unless the size of wage and salary increases moderated.

Here the results were much more disappointing. It was not possible to reach any agreement on pay increases after the establishment of the price restraint program, and when a unilaterally determined upper limit of six per cent was put forward, employee groups opposed it vigorously. There are differences of view on the results of this initiative, the most common opinion being that the six per cent upper limit had some positive effects in reducing wage and salary increases but the total impact was quite small. When, therefore, the termination date of the price restraint program drew near, the business community rejected the suggestion that they should carry on a one-sided program after the end of 1970, and the price and income restraint program came to an end on December 31, 1970. To the extent that the Commission has been active in current operations, it has restricted itself to fact-finding studies. Most of the Commission's efforts over the past year have been devoted to writing a report on the problem of inflation and in preparing contingency plans for a price and income control system if this should prove necessary in the future.

The general agreement we sought in 1969 had many similarities to the program undertaken recently by the United States. While our scheme was often described as a voluntary one, it was envisaged from an early stage that governmental intervention on a significant scale would be required to ensure that the program was sufficiently

comprehensive and effectively administered. The crucial difference between the effort made in Canada in 1969 and in the United States in 1971 is that the Americans acted at a time of crisis with a strong national consensus and imposed an initial freeze under the force of existing law. Even with all this in their favor, it is evident that the task is not proving to be an easy one.

In offering some reflections on what has been learned over the course of the last two or three years I would like to go back to a topic I discussed in Toronto in early December; that is, the extent to which one's view of the causes of the kind of inflation we have been experiencing recently determines one's attitude towards the possible usefulness of prices and incomes policy. The rather surprising conclusion is that in dealing with the disease of inflation there does not appear to be a close connection between diagnosis and prescription. Those who disagree on the diagnosis often agree on advocating some form of price and income restraint while those who agree on the causes of inflation sometimes hold differing views on policy. I would like to illustrate this conclusion by referring to recent events and discussions in this country and in the United States.

Let me first talk very briefly about differing views on the causes of inflation. Over the course of the last couple of centuries there have been two

broad approaches to this question. One has been to look at particular decisions to raise prices and incomes and attribute the resulting general inflation to the tendency of individuals and groups to take advantage of their fellow men. The second has been to look to a more general cause, namely, the degree of demand pressure placed on the economy's capacity to supply goods and services at the existing price level. For most of the last two centuries, the principal influence determining the level of money expenditure was thought to be the quantity of money in the system. Following the development of Keynesian economics 35 years ago, a number of economists have given the quantity of money a less precise and direct influence over the level of money expenditure, but the basic theory of inflation remains the same. Although imprecise, the graphic description of inflation as too much money chasing too few goods applies equally well to the Keynesian theory of inflation as to the classical theory.

There has been a handful of people for some years who have argued that institutional developments in modern society have created conditions under which there is a tendency for prices and incomes to rise even in the absence of an excess of demand in money terms. Some have placed their principal emphasis on the growth of corporations, others on the development of trade unions, but whether looking at either or both they have seen an explanation for continuing increases

in prices and costs which did not depend on excess demand. This body of thought received comparatively little support in North America in the first decade or so after World War II. There were several reasons for rejecting it. First, it was difficult to find a satisfactory theory to explain why unions and corporations would behave in the way which was predicted and second, difficult to find evidence to support such hypotheses as were forthcoming. Moreover, the historical record suggested that, in general, countries allegedly suffering recurring cost-push inflation in fact had had recurring levels of high demand. Thus, it was not apparent that a new explanation was required.

This remained the state of affairs until the recession of 1957-58 when for a number of months unemployment was increasing rapidly in North America while price and wage increases continued to run at a significant level. This was perhaps less unusual than it appeared to be at the time, but it quickly had the effect of increasing the popularity of the hypothesis that it was the market power of corporations or unions or both,rather than the pressure of demand,which was responsible for inflation. As a result of this recession and the one which quickly followed in 1960-61, the rate of price and wage increase fell off sharply and confidence in the demand theory was restored. When, however, we encountered similar problems in recent years,the market power theory was brought forward again and received a good deal of popular

support, particularly that version which lays stress on the market power of the unions.

An alternative explanation of what we have been seeing lately puts much greater emphasis on the part played by institutional lags in the process of wage and price adjustment (such as those introduced by the existence of long-term contracts) and by the persistence of beliefs and patterns of behavior generated by past experience of continuing inflation. In 1969 after a period of more than 35 years in which the price level had been moving in an upward direction, a period of nine years of uninterrupted economic expansion and more than four years of rapid inflation, it was not to be expected that it would be easy to change people's views about the likelihood of a continuation of inflation on a significant scale.

The market power and demand theories have been the two major contending views of inflation in the United States in recent years and it might be expected that the theory chosen would influence the view taken of the desirability of incomes policy. A few months ago this seemed to be the case. As you are aware, one of the most forceful advocates of the market power diagnosis was our famous expatriate, the President of the American Economic Association, John Kenneth Galbraith. Professor Galbraith believes quite strongly that recent inflation is particularly associated with the price-raising activities of corporations and, to a lesser extent, unions, and has been an advocate of price and wage controls for some time. Over many months this view of the economy was rejected by the Nixon Administration.

As recently as July 1971 Paul McCracken, the then Chairman of the Council of Economic Advisers, attacked Galbraith's view of the nature of the price system and described it as one still common among uneducated people and unusual only in being held by the President of the American Economic Association, and in being described by him as new. Within a matter of weeks, however, the U.S. Government appeared to adopt Galbraith's policy prescription of wage and price control. Was this the result of an overnight conversion to a Galbraithean interpretation of the economy? The answer is clearly no. The Report of the Council of Economic Advisers for 1972 described the raison d'être of the control program in the following terms:

> "The basic premise of the price-wage control system is that the inflation of 1970 and 1971 was the result of expectations, contracts, and patterns of behavior built up during the earlier period, beginning in 1965, when there was an inflationary excess of demand. Since there is no longer an excess of demand, the rate of inflation will subside permanently when this residue of the previous excess is removed. The purpose of the control system is to give the country a period of enforced stability in which expectations, contracts, and behavior will become adapted to the fact that rapid inflation is no longer the prospective condition of American life. When that happens controls can be eliminated."

The fact that the American program is temporary indicates the difference in interpretation. If one supports the market-power view of inflation, then the problem can only be met on a continuing basis by a permanent system of controls, or by fundamental institutional changes which reduce the power of unions, corporations, professional associations and other groups to influence the determination of their prices or incomes. Such institutional changes may well be desirable on other grounds, but given the difficulty of altering the whole structure of our economy, are not likely to provide an answer in the near future. A Galbraithean view of the economy tends to lead, therefore, to a permanent system of controls, while the analysis of inflation of the U.S. Administration leads to a temporary program.

The difficulty of keeping these distinctions clear is well illustrated by the recent report of the Canadian Senate Committee on National Finance. While the Committee saw some possibilities for the limited use of incomes policy, on the whole they took a negative position towards guidelines and controls. This negative position was in part based on a strong dislike for direct interference in the economy but also in part on the mistaken view that "one basic condition for the use of peacetime controls would be the acceptance by the authorities of a cost-push inflationary diagnosis strongly related to the exercise of market power." Since the Senators are dubious about this

explanation and instead stress lags, expectations and international influences in explaining the persistence of inflation they conclude that there can be no strong case for controls. It is the Commission's position that the view of the inflationary process held by the Senate Committee does not necessarily lead to the Committee's negative conclusions on incomes policy.

Since I have made one reference to the work of the Senate Committee, it may be worthwhile to add a few more words on the reaction my colleagues and I had to their report. You should perhaps make an allowance for bias. The position we took in our testimony on the use of prices and incomes policy was not reflected to any great extent in the Committee's conclusions. You can, therefore, perhaps put down some of what I have to say to the slight blow to our pride at their failure to follow our advice. That advice was that while we had no enthusiasm for the use of price and income restraint policies, we could see that under certain circumstances these policies could play a useful supplementary role to demand policies.

Whenever a person or group is able to take as negative a position on incomes policy as that of the Senate Committee, the question arises of how they found an escape from the dilemma which confronts economic management.

This dilemma can be stated simply. In Canada in recent years attempts to reduce the level of unemployment by expanding demand have led to sharply intensified cost and price pressures at national levels of unemployment which have been uncomfortably high. Attempts to check these rapid increases in costs and prices by means of demand policies alone have led to even more painful levels of unemployment. What is to be done?

One way of resolving the dilemma is to say that if a choice has to be made between unemployment and inflation, one should accept inflation. This is a widely-held view but is not the position taken by the Senate Committee. It is true that they accept a somewhat higher than traditional objective for price increases, 2 - 3 per cent on the consumer price index. It is also the case that their discussion of the trade-off suggests that they think some significant long term gains in employment can be had from continuing inflation. But taken as a whole their report does not show more than a mild tolerance for inflation.

A second conceivable alternative is to accept a less ambitious view than that widely held by the public of the level of unemployment which can be maintained without inflation. This the Committee did. While arguing that the Economic Council objectives of three per cent unemployment and a rise in the consumer price index of no more than 1.5 per cent were valid goals for the longer term, the

Committee recommends that a level of unemployment of 4 - 4½ per cent as an interim target is more appropriate to the present structure of the Canadian economy. This is a recognition of the need for greater realism about the level of unemployment consistent with economic stability in a country with such wide regional differences. It goes some way to explain how the Committee felt they could escape the need for controls.

Two further ways of escaping the dilemma were given a good deal of attention by the Committee. One possibility is that by means of supply and structural policies such as manpower and competition policies, the level of unemployment at which serious inflation develops could be reduced. The second possibility is that better performance could be achieved through improvements in both selective and general demand policies. In discussing these lines of attack on the problem the Committee acknowledges the very real difficulties involved in making significant progress, but it is sufficiently optimistic of the outcome to give a generally negative verdict on the use of prices and incomes policy, including temporary resort to controls.

It would be comforting if we could be as optimistic as they are. Many of us share their general distaste for direct intervention in individual price and income decisions, both on economic grounds and because of the effects on individual freedom. Moreover, almost all of us are aware of

how difficult it is to ensure that any intervention of this kind is effective. Finally, foreign experience and economic analysis make it clear that any program of restraint can only be successful, and removed without serious adverse effects, if the demand policies being followed both during and after the period of restraint eliminate the overheating of the economy. For all these reasons, one would like to think that prices and incomes policy could be left to one side. The Commission, however, has not changed its view since appearing before the Senate Committee last May that circumstances may yet arise in which resort to price and income restraint will be seen as the least of the evils confronting us.

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